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Commerciality: Real Savings?

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Commerciality: Real Savings?

Robert Hazlewood—is a Senior Quality Auditor in the Policy, Quality, and Legislative Affairs (PQLA) Directorate at the Defense Contract Audit Agency. Hazlewood leads teams of quality auditors (QAs) performing reviews of audits for compliance with Generally Accepted Government Auditing Standards (GAGAS), AICPA attestation standards (AT-Cs), and Agency policy. He assists in developing the annual quality review plan, conducting quality reviews, and works with DCAA Policy staff on matters impacting audit quality.

In 2024, he was selected to assist with a strategic improvement group (SIG) to address changes needed to comply with the 2024 Yellow Book. Hazlewood provided input throughout the process, covering every aspect of DCAA's system for ensuring audit quality. He was integral to mapping existing and "to-be" post-issuance review processes for audit engagements.

Prior to serving in PQLA Hazlewood was a Branch Manager in DCAA, overseeing the operations of field audit offices from 2012 to 2020. He was a Supervisory Auditor from 2003 to 2012, including a five-year tour in the European Branch Office in Wiesbaden, Germany. Hazlewood has also served as a Financial Liaison Advisor at Tinker AFB, OK from 1999 to 2003.

Hazlewood holds a Bachelor of Accountancy and Master of Public Administration Degrees from the University of Oklahoma. He completed the Director's Development Program in Leadership in 2019, and holds Level III certifications in DAWIA, FM, and DoD Defense Acquisition Corps. Hazlewood is a CPA in the State of Oklahoma since January 1990. [robert.c.hazlewood.civ@mail.mil]

Cher Mount— serves as a Contract Cost/Price Analyst within Team ACBB of the Cost and Pricing Command of DCMA. Her responsibilities include managing and reviewing a portfolio of proposals, issuing recommendations to proposals, and conducts rate and progress payment reviews for the Armed Forces Contracting Offices and teams within DCMA. In addition, Mount held a temporary Supervisor Position for Team ACBB in 2023. Her responsibilities included, managing the workload for the team to ensure proper assignment, review, and oversight. Prior to working within the Cost and Pricing Command, Mount has experience working as a Contractor Administrator with DCMA. Her responsibilities inncluded contract administration services such as assisting in the negotiating of un definitized contract actions, review, and closeout.

Prior to her responsibilities as a Contract Cost/Price Analyst, Mount began her career working as a Contracting Officer for Army NAF Contracting in Fort Campbell, Kentucky. She was responsible for the cradle to grave of contracting administration actions to include construction projects within the Southeast Region.

Mount has earned a Bachelor of Science in Business Administration and a Bachelor of Arts in Elementary Education from Point Park University in Pittsburgh, Pennsylvania. In 2017, Mount earned her MBA with a concentration in Public Administration from Columbia Southern University in Orange Beach, Alabama.

In her personal capacity and as an advocate for veterans, she volunteers for the nonprofit, Tails of Valor/Paws of Honor in Coopersburg, Pennsylvania as the Secretary of the Board of Directors. [cher.e.mount.civ@mail.mil]

Abstract

Commercial item pricing is viewed as a way to reduce costs to the Government. This has not been meaningfully assessed in relation to "of a type" commercial items where there is not a competitive commercial marketplace to shape prices. This research and panel would assess whether this type of part pricing is creating savings.

Introduction

Commercial, Commercial, Commercial. "Law has directed a preference for commercial item procurement since the early 1990s" (DoD, 2019, p. 4). This paper outlines a specific precept behind this preference (i.e., money savings) and examines whether the expected

benefit has manifested.

Do costs decrease when products are treated as commercial? Proponents of classifying items as commercial point to fiscal savings promised by not having to follow FAR Part 15 and Cost Accounting Standards. For example, the regulations provide for obtaining cost data only if needed to determine a fair and reasonable price. The information provided by the offeror on sales to other commercial customers, market analysis by the acquisition team, assistance by the DCMA Commercial Item Group (CIG), and other available resources should enable the government to pay a fair and reasonable price. Industry also champions the potential time savings afforded by commercial item procurement.

In Defense acquisition, there have long been cost challenges related to "military specifications" that require solutions that differ from the commercial marketplace and therefore dramatically increase costs. The push for the utilization of commercial items to decrease costs is rooted in some core cost principles. First, commercial items allow the seller to spread overhead costs out over more customers and as a result lower prices for any individual customer who may have shouldered that burden alone. For example, a commercially developed item will reduce the need for the Department of Defense (DoD) to pay for the research, development, and testing associated with deploying a new product. Ongoing engineering requirements assuring that products are not impacted by product or part obsolescence is also spread across many buyers. Second, commercial items are controlled by free market competitive forces and as a result the need for insight into cost data is eliminated. Finally, proposing and negotiating on the basis of costs in compliance with the FAR/DFARS/CAS creates administrative burden that must be borne by the product price.

However, not every "commercial item" is created equal. The statutory definition of a commercial item allows for broad consideration of commerciality when a part is "of a type" made commercially. In this instance, competitive free-market forces do not shape prices.

There are two distinct "of a type" situations—1) where the contractor sells something themselves and 2) where they use commercial sale of an item by another party to justify their item to be "of a type." In this instance, it is not axiomatic that items previously obtained from sole source vendors using cost or pricing data (certified or not) result in savings to the government once these items are classified as commercial. As early as 1998 the Department of Defense Inspector General (DoDIG) has reported instances of overpricing when items are classified as commercial, and the buying office limited the data it considered when negotiating. There have been numerous audits where the DoDIG concluded the Contracting Officer failed to review sufficient information to determine negotiated prices were fair and reasonable for items classified as commercial.

In fact, after a commercial item determination (CID) has been made for an item previously purchased based on cost analysis, there is evidence that prices increase. Contractors assert that commercial item pricing results in a lower cost due to the removal of the administrative burden of Truth in Negotiations (TIN) and FAR Part 15 requirements. They assert that determining whether CIDs provide cost savings to the government would include other factors besides looking only at unit prices (e.g., cost to audit and provide cost analysis, maintenance of business systems, compliance with Cost Accounting Standards). However, these requirements remain for sole source acquisitions exceeding specified thresholds.

This paper explores an alternative hypothesis—that costs actually increase when products are treated as commercial—by examining prices paid for specific parts under both FAR Part 12 (commercial) and FAR Part 15 (negotiation) approaches. Using DCMA Commercial Item Group (CIG) data (not publicly available) for specific part numbers, we conducted an evaluation to determine whether the trend shows an overall increase or decrease

in prices, and overall impact for the period reviewed. This deep dive into the DCMA CIG data is designed to illuminate whether there were realized cost benefits to the government.

The CIG data reviewed included 1,792 line items of data covering the period 2018 to 2024. For our review, we focused on instances where the difference between proposed and CIG recommended amounts were equal or greater than $1 million. This resulted in 87 items with a total proposed value of $1.458 billion for 28 different contractors and 66 different part numbers.

Steps we Took to Evaluate the Research Issue/Problem Statement

We determined that we would attempt to compare prices reflected in the DCMA CIG data to prices previously proposed under FAR Part 15 when cost or pricing data would have applied. To do this, we set out to contact the requestor (buying activity) for selected cases based on an analysis of the DCMA CIG data.

We analyzed the DCMA CIG data and determined that in many cases the recommended price was substantially lower than proposed. The information included prime contractor and subcontractor names and CAGE Codes, part numbers and descriptions, quantities, proposed and CIG recommended unit prices and total price, and CIG Case Numbers. The CIG data included 60 different prime contractors with 380 different part numbers with a total proposed amount of $2.714 billion. The average decrement exceeds 20% when exceptions are taken to proposed prices. We also noted that in instances where exception amounts exceeded $1 million (87 examples) the average decrement exceeded 35%. We conclude from this that the DCMA CIG group is successful in identifying overstated proposed costs when evaluating “of a type” commercial items.

The DCMA CIG data includes several useful fields, such as DCMA Case Number, Prime Contractor and Subcontractor name and CAGE codes, Description, Quantity, Proposed and Recommended Unit Price, Proposed and Recommended Price, Part Numbers (Prime and Sub), Requesting Command, End Customer, Program, and Report Date to Customer.

We determined that we needed the DCMA CIG’s assistance to identify the specific requestor associated with each Case Number. Further, in instances where DCMA Cost and Pricing (C&P) was the requestor, we needed C&P assistance to identify the originating buying activity. This delayed our research and highlights the difficulty in identifying the appropriate points of contact (POC).

Results of Data Requests to Buying Activities

We learned the following when researching the parts included on the spreadsheet provided by the DCMA CIG:

1. It is not a simple task to identify the appropriate organizations and individuals able to provide the necessary information. The identifiers we used from the spreadsheet included DCMA CIG Case Numbers, and CAGE codes for prime contractors and subcontractors. We needed assistance from the DCMA CIG to trace the Case Numbers to the original requestors (buying activities.) This was not always successful due to personnel movement, and invalid e-mail addresses. The CAGE codes were not especially useful, since they did not provide POCs for the buying activities.
2. The information provided by one buying activity was limited to the same information already presented on the DCMA CIG spreadsheet (e.g., same unit prices proposed). We requested information regarding the procurement

preceding this one, and we received data on six part numbers (see Table 1).

3. One buying activity representative we spoke to stated that a recent comparison would be problematic due to the impact of COVID on pricing. This buying activity negotiates multi-year buys every five years, with the one reflected in the DCMA CIG data being in June 2022. The unit prices increased 106& from the June 2022 buy to the current buy being negotiated. These increases were due to multiple factors such as inflation, supply chain issues, and suppliers unwilling to provide multi-year pricing. Another complicating factor with this example is the subcontractor is a foreign concern.
4. Previous buys under FAR Part 15 may be at different quantities than those reflected on the DCMA CIG spreadsheet, and this along with escalation would need to be considered in any comparison.
5. Information on subcontractor proposed prices may not be readily available. The Price Negotiation Memorandum (PNM) may not have this level of detail. Further, the ability of a buying activity to readily access needed information (e.g., copies of subcontractor proposals) varies by Service.
6. We reached out to DCAA to discuss the feasibility of enlisting field audit offices with searching their files for copies of subcontractor proposals. However, this is a labor- intensive task and resource constraints prevent a detailed search of historical audit files which may not contain the desired information.
7. We utilized the commercial website nsn-now.com to research part number history to obtain solicitation numbers. We then tried to locate the solicitations for applicable part numbers in USAspending.gov, giving us the DUNS number. However, we were still unable to locate the corresponding award data within the Procurement Integrated Enterprise Environment (PIEE) or what is formerly known as the Wide Area Workflow (WAWF).
8. We surveyed the CIG for insights on procedures they use to evaluate price reasonableness.

Table 1. Responses

PRICE PAID FROM PRIME TO SUBCONTRACTOR	CIC					CUSTOME RESPONSE				
	DATE	PART NUMBER	QTY CIG	UNIT PRICE PROPOSED CIG	UNIT PRICE RECOMMENDED CIG	DATE	PART NUMBER	QTY CUSTOMER	UNIT PRICE CUSTOMER	FOOTNOTE
DATA NOT PROVIDED	11/13/2018	8450840-1	525035	$ 67.07	$ 55.67	11/16/2015	8450840-1	42,000	$ 73.53	Above TINA, not commercial
						10/1/2018		105,007	$ 64.60	Commercial Item
						11/14/2023		63000	$ 72.38	Commercial Item
	6/23/2022	530-005378-000	75	$ 115,842.24	$ 63,939.00	NO DATE PROVIDED	530-005378-000	13	$ 115,500.00	Prior to CD Case S5113A22C0326 Date 6/23/22
								3		
								17		
								7		
								19		
								6		
								4	$ 119,320.75	
								6	$ 117,230.77	
	6/23/2022	530-005384-000	95	$ 169,296.62	$ 140,407.00		530-005384-000	7	$ 171,473.68	
								7		
								17		
								12		
								21	$ 168,428.57	
								31	$ 166,864.86	
	6/23/2022	014-000009-000	64	$ 101,385.25	$ 73,361.00		014-000009-000	16	$ 101,385.25	
								16		
								12		
								12		
								4		
								4		
	12/19/2022	19E203-2BCL97	900	$ 9,898.53	$ 8,441.40	3/15/2005	19E203-2BCL97	47	$ 3,508.00	Historical Pre Commericality
						7/26/2005		44		
						11/23/2005		44	$ 3,530.00	
						6/20/2006		90		
						8/31/2006		25	$ 5,525.00	
						1/31/2008		50	$ 5,855.00	
	10/24/2019	2060041-1	50	$ 50,309.00	$ 27,842.00	NO DATE PROVIDED	2060041	220	$ 51,181.00	Government's final negotiated per unit amount is slightly higher than the DCMA-recommended position, yet it still represents a significant cost savings compared to the initial proposed amount
	10/10/2024		220	$ 60,799.00	$ 50,366.00					

Overall Conclusions of Research

As shown in the table above, when data was provided it is not easy to ascertain the reasons for the pricing variance. Due to elapsed time, escalation could be a factor; quantity variances also impact the comparability of the data.

Our research disclosed that it is difficult to compare proposed prices for commercial parts to proposed prices before the same parts were determined to be commercial. The DoDIG audits have reported instances where historical cost-based prices for parts increased substantially when classified as commercial, but these are anecdotal examples and cannot be projected to the universe of commercial acquisitions. Likewise, our attempt to make a comparison of DCMA CIG data to prior cost-based purchase history was largely unsuccessful.

The response rate to our data request was impacted by the difficulties locating the appropriate buying office personnel. In several instances the names provided were not the current individual cognizant of the applicable program.

In one instance we were advised that the records were in paper format and would be labor and time-intensive to retrieve. Due to the time and resource constraints on our research, we did not require the additional effort.

Recommendations

To improve the ability to make meaningful comparisons in the future, consider establishing a unified part number database for government access, similar to what exists in PIEE (FED-LOG) or commercially (nsn-now.com). The database should provide historical prices paid and whether FAR Part 12 or Part 15 is applicable. The pricing data should include applicable fiscal year and quantity information, prime contractor and/or subcontractor part numbers, and National Stock Number (NSN) information for each part. For example, the first step would be to standardize an EBOM where the contractor/subcontractor provides actual prices paid in the same consistent format on all acquisitions. Next, a database for the DoD to exploit based on the standardized EBOMs could be developed. This would provide information not currently available in PIEE.

Another recommendation is for contracting officers to quickly determine if price and market-based analysis is insufficient to make a determination of fair and reasonable price. If cost data is needed and the contractor will not agree to provide, time is of the essence to elevate the matter to achieve resolution. Contractors have little incentive to provide cost data to support proposed costs for commercial items, especially if the cost data would reveal excessive profit. The excessive profit paid for commercial parts erases any perceived benefit to the government and reduces the number of items that can be procured for the warfighter.

Commercial item determinations are most often made at the subcontract level. The Government generally sees the proposed price and forms a price that they consider negotiated in negotiations with the prime, but the prime will most often negotiate a price that is different than the Government position during performance of the prime contract. Since the Government does not routinely collect and aggregate the prices paid each year, it becomes exceptionally difficult to compare pre-CID and post-CID prices.

What Goes Wrong When Negotiating Prices for Commercial Items?

Various DODIG reports have cited the following problems identified during its review of commercial acquisitions:

- A sole-source supplier with technical data rights set “market-based” catalog prices for commercial items at “what the market would bear,” and there was no competitive commercial market to ensure the reasonableness of the prices;
- Contractor refused to negotiate catalog prices for commercial items based on price analysis of previous cost-based prices, refused to provide contracting officers with

"uncertified" cost or pricing data for commercial catalog items, and terminated Government access to its cost history system;

- The contracting officer did not perform an adequate analysis when procuring sole-source commercial parts; specifically, the contracting officer used the previous DoD purchase price without performing historical price analysis and accepted the contractor's market-based pricing strategy in a noncompetitive environment without performing a sufficient sales analysis. The contracting officer did not obtain cost data to perform cost analysis;
- The contracting officer did not conduct sufficient price analysis in accordance with federal and defense acquisition regulations. Specifically, the contracting officer:
    - relied on previous over-inflated contract prices to determine the current contract prices;
    - did not sufficiently analyze the "commercial of a type" parts to determine whether the sales of comparable parts supported the contract prices;
    - accepted excessive prices for new quantity ranges; and
    - did not compare commercial sales to Government sales to determine whether sales were sufficient to support commercial part prices;
- The contracting officer did not appropriately determine fair and reasonable prices for sole-source commercial spare parts purchased from the contractor. This occurred because the contracting officer did not conduct a sufficient price analysis. Specifically, the contracting officer:
    - relied on sales data that did not include customer names;
    - did not review commercial sales quantities; and
    - accepted prices for sole-source commercial parts with no commercial sales.
    - Further, the contracting officer did not question the commercial off-the-shelf classification for parts with no commercial sales, and did not require the contractor to comply with a contract requirement to submit negotiation documentation within stated timelines.

In two of the DoDIG reports reviewed, the DoDIG had to issue subpoenas to the contractor to obtain other than certified cost data. The contracting officer is at a decided disadvantage because contractors are hesitant to provide cost data to support pricing for commercial items. Cost data is last on the list of items the contracting officer should review to determine price reasonableness.

Conclusion

In conclusion, identifying potential savings (or, alternatively, cost increases) for "of-a-type" commercial supplies and services is not straightforward, commerciality savings is not as clearly defined in procurement of government supplies and services based on the currently available information. This is due to several factors: 1) EBOMS are not standardized to include FAR Part 12 or 15 applicability making comparisons difficult; 2) the supplies or services are often provided by subcontractors. The government may complete negotiations with the prime before the prime completes negotiations with the subcontractor. In these cases, only the prime contractor has visibility of the negotiated price between the prime and subcontractor for a particular supply or service. If EBOMS were standardized and required to include prices negotiated between prime

and subcontractor, a database could be developed and used by the government to evaluate fair and reasonable pricing in future buys.

In the absence of a true commercial market to determine a fair and reasonable price for an “of-a- type” commercial item, there must be better tools available to the contracting officer. While cost data to support proposed commercial prices is a “last-resort,” it may be the only valid way if other methods have failed. Highly redacted or limited sales history, for example, is not sufficient just because the contractor/subcontractor makes proprietary assertions or has limited sales. If the contracting officer requires cost data to establish a fair and reasonable price, the regulation should make it easier to obtain cooperation. The DCMA CIG data used in our research clearly shows that proposed prices for commercial “of-a-type” items are often overstated. Contracting officers should continue to seek assistance from the DCMA CIG for pricing help on commercial items.

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Department of Defense Management
Naval Postgraduate School
555 Dyer Road, Ingersoll Hall
Monterey, CA 93943

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